E-015/M-91-458 ORDER ESTABLISHING DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Proposal of Minnesota Power for a Demand-Side Management Financial Incentive

ISSUE DATE: March 12, 1992

DOCKET NO. E-015/M-91-458

ORDER ESTABLISHING DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS

PROCEDURAL HISTORY

I. Proceedings to Date

On February 28, 1991 the Commission issued an Order requiring all investor-owned electric utilities serving more than 500 Minnesota customers to file plans for financial incentives to promote demand side management. In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand-Side Resource Options for Minnesota Electric Utilities and Bidding Systems, Docket No. E-999/CI-89-212, ORDER REQUIRING ELECTRIC UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS IN 1991 (February 28, 1991). On October 1, 1991 Minnesota Power (the Company) filed its demand side management incentive proposal.

The Department of Public Service (the Department), the Residential Utilities Division of the Office of the Attorney General (the RUD-OAG), and an association of taconite producers receiving service under the Company's large power tariff (the Taconites)[1] filed comments. The RUD-OAG supported the Company's proposal. The Department supported it with modifications. The Taconites opposed it.

The matter came before the Commission on February 5, 1992.

[1] Those companies are Eveleth Expansion Company, Eveleth Taconite Company, Hibbing Taconite Joint Venture, Inland Steel Mining Company, National Steel Pellet Company, and USX Corporation.

FINDINGS AND CONCLUSIONS

II. The Company's Proposal

Minnesota Power proposed a two-part financial incentive. First, the Company proposed full recovery of all margins lost due to energy savings achieved through successful Conservation Improvement Plan (CIP) projects. Lost margins were defined as all unrecovered non-variable costs within a specific rate. The Company proposed to book estimated lost margins to its CIP tracker account monthly, and to adjust those amounts annually to reflect actual savings, as determined in annual CIP program evaluations.

Second, the Company proposed a Double Shared Savings Incentive, which would split the savings from large, cost-effective conservation projects between ratepayers and shareholders. Most of these projects would involve large commercial or industrial customers, who would repay the Company's investment in installments added to their electric bills. The Company proposed that ratepayers and shareholders share the difference between project costs and energy savings, using a sliding scale which increases ratepayers rewards as the ratio between energy savings and costs increases.

Under the Company's proposal, sharing would range from 100% to shareholders at a benefit/cost ratio of 1.0 to 100% to ratepayers at a benefit/cost ratio of 2.0. The Company's targeted cost/benefit ratio would be 1.2, with a ratepayer/shareholder sharing ratio of 20%/80%. Ratepayer sharing amounts would be credited to the CIP tracker account. Shareholder sharing amounts would be credited below the line and treated as unregulated revenues.

III. Parties' Comments

The RUD-OAG recommended approving the Company's proposal as an appropriate financial incentives pilot project.

The Taconites argued that, since the Company was now required by statute to invest specified sums in demand side management, financial incentives for demand side management were no longer necessary or appropriate. Minn. Stat. § 216B.241, subd. 1a (Supp. 1991).

The Department recommended approving a modified version of the Company's proposal as a two-year pilot project. The Department wanted to allow full recovery of lost margins only if the Company met or exceeded its CIP program goals and wanted to modify the Double Shared Savings Incentive to provide 50/50 sharing between ratepayers and shareholders regardless of cost/benefit ratios. Finally, the Department recommended requiring the Company to file a detailed plan for measuring energy savings, and a plan for evaluating the effectiveness of the pilot project, within 30 days.

The Company stated its willingness to adjust the Double Shared Savings Incentive sharing ratio to 50/50, but opposed linking full margin recovery to its success in achieving its CIP goals. The Company accepted the rest of the Department's recommendations, but asked that its plans for measuring energy savings and evaluating the pilot project be due in 45 days instead of 30.

IV. Commission Action

A. The Statutory Standard

The Public Utilities Act authorizes the Commission to require utilities to develop financial incentives for demand side management and requires the Commission to consider the following factors in evaluating those plans:

(1) whether the plan is likely to increase utility investment in cost-effective energy conservation;

(2) whether the plan is compatible with the interest of utility ratepayers and other interested parties;

(3) whether the plan links the incentive to the utility's performance in achieving cost-effective conservation; and

(4) whether the plan is in conflict with other provisions of the Public Utilities Act.

Minn. Stat. § 216B.16, subd. 6c (Supp. 1991).

B. The Appropriateness of Financial Incentives

The Commission appreciates the Taconites' contention that utilities should not be given financial incentives to invest in demand side management now that they are required by statute to do so. At the same time, however, the Commission recognizes that financial incentives may increase the quality and quantity of utilities' demand side efforts, producing the significant energy savings the statute aims to achieve.

Requiring utilities to spend specified amounts of money on conservation is one thing; harnessing their creativity on behalf of conservation is another. The Commission believes that financial incentives may be a useful tool for encouraging utilities to do more than comply with statutory spending requirements, to focus their creative energies on conservation. The Legislature apparently agreed, since in 1991 it authorized the Commission to require utilities to file financial incentive plans and established factors to consider in acting on those plans. Minn. Stat. § 216B.16, subd. 6c (Supp. 1991).

The Commission concludes that it is in the public interest to establish financial incentives for Minnesota Power to invest in demand side management. By doing this, the Commission is not finding that financial incentives are in the public interest and should become a permanent part of electric utility ratemaking. It may turn out that financial incentives are useful primarily as devices to ease the transition from supply side management to a combination of supply side and demand side management. It may turn out that the role of financial incentives should be limited to encouraging utilities to find and implement the most cost effective conservation programs possible. For now, however, the Commission is convinced it is in the public interest to explore the potential of financial incentive programs designed by individual utilities to increase their individual use of demand side management.

C. Full Recovery of Lost Margins

The Department urged the Commission to tie Minnesota Power's recovery of lost margins to achievement of its CIP goals. The Department is rightly concerned with performance; two of the four factors the statute requires the Commission to consider in acting on incentive proposals deal with performance. The Commission believes, however, that for purposes of this pilot project, limiting recovery to margins actually lost due to conservation adequately ties recovery to performance. Only when energy has been saved will the Company recover lost margins.

Furthermore, allowing recovery of lost margins really amounts to little more than eliminating the obstacle of regulatory lag to encourage conservation. The Company could file annual rate cases and accomplish the same thing. It can be argued that this is what the Company should do, since the general rate case is the natural vehicle for adjusting rates to reflect changes in sales volumes. It can also be argued that it would be unduly harsh to require the Company to file a general rate case to be made whole for losses it is required to incur by law and public policy. Both arguments have merit. The Commission is convinced, however, that at this stage in the effort to promote heavier reliance on demand side management, it makes sense to remove the obvious obstacle of lost margins.

The Commission finds that recovery of lost margins is in the public interest, is consistent with the standards set forth at Minn. Stat. § 216B.16, subd. 6c (Supp. 1991), and should be approved.

D. Double Shared Savings Incentive

The Company concurred in the Department's recommendation to modify the Double Shared Savings Incentive to provide for equal sharing between ratepayers and shareholders. The Commission agrees that equal sharing is the most equitable approach. The Commission believes even modest energy savings should benefit ratepayers as well as shareholders, and therefore welcomes the withdrawal of the early proposal to award all early energy savings to the Company. At the same time, given the importance and difficulty of designing and implementing large scale cost-effective conservation projects, it makes sense to continue to reward the Company as cost-benefit ratios of successful projects climb.

The Commission finds, applying the statutory considerations and its own expertise, that the Double Shared Savings Incentive is in the public interest and should be approved. The Incentive is likely to increase investment in cost-effective energy conservation; it is compatible with the interests of ratepayers and other interested parties; it links the incentive with performance in achieving cost-effective conservation; it does not conflict with other provisions of the Public Utilities Act. Minn. Stat. § 216B.16, subd. 6c (Supp. 1991).

E. Reporting and Evaluation Requirements

The Commission agrees with all parties that it would promote administrative efficiency to examine lost margin calculations in conjunction with the Company's annual CIP evaluation filing. The Commission will therefore require the Company to file its calculations of lost margins and Double Shared Savings Incentive amounts annually on April 1.

This incentive proposal is being approved as a two year pilot project. To ensure meaningful data at the end of the two-year period, it is important to have a workable plan for evaluating the project's results. The Commission will require the Company to file a plan for evaluating the success of the pilot project within 45 days of the date of this Order.

Similarly, to avoid as many future conflicts as possible, it is important to have a working understanding of how lost margins attributable to conservation will be measured. The Commission will therefore require the Company to file a proposal for measuring lost margins within the same 45 day period.

ORDER

1. Minnesota Power's financial incentives proposal, as modified above, is approved as a two year pilot project.

2. Within 45 days of the date of this Order, the Company shall file a plan for measuring lost margins attributable to conservation and a plan for evaluating the financial incentives pilot project.

3. Any party wishing to file comments on the Company's plan for measuring lost margins or its plan for evaluating the pilot project shall do so within 30 days of the Company's filing.

4. The Company shall file its calculations of lost margins and Double Shared Savings Incentive amounts annually on April 1.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)